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ADDRESS OF

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Before the

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INDUSTRIAL BANKS — RETROSPECT AND PROSPECT

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Gentlemen:

I appreciate greatly the opportunity to participate with you in your annual convention. I have had pleasant associations with several staff members of your national office almost ever since my arrival in Washington 9 years ago, and I am glad to become acquainted with the membership of the group which has played such a large part in providing credit for the individual in this country.

In the time available to me, I shall try (a) to survey in retrospect the drastic changes in the character of industrial banks in recent years (b) to appraise their present status as shown by reports submitted to us, and (c) to present for your consideration some observations based upon prospective developments in consumer credit and commercial banking.

I

In any history of consumer credit in this country there are several recent dates which are sure to be mentioned. These include 1941 and 1945. For it was in 1941 that the volume of consumer instalment credit reached 6 billion dollars. This was double the amount outstanding in 1929 — a year of records in so many other fields. From that peak of 6 billion dollars the figure dropped rapidly to 2 billion dollars in

1943, where it remained until the early fall of 1945. In the past year, as you know, the increase has been very rapid — by more than 50 percent, to over 3 billion dollars.

(Parenthetically, in case any of you feel that I am understating the figures, I should mention that these figures are for consumer instalment credit only and do not include single-payment loans to consumers, charge accounts at department stores, or so-called service credit; noninstalment consumer credit has fluctuated between 3 and 5 billion dollars in the past, and is frequently included by speakers who quote a total consumer credit figure.)

Those years 1941 and 1945, which mark the prewar peak of consumer credit and the beginning of re-expansion after the wartime contraction, are the significant signposts which I should like to use in our retrospective view — surveying developments among industrial banks. When I use the term industrial banks, I am for the most part referring specifically to insured industrial banks, because I have had their figures available for analysis and study. A considerable proportion of the insured industrial banks are members of this Association; conversely a considerable proportion of your members are insured banks; I believe, therefore, that you will be interested in what our figures show with respect to insured industrial banks.

When I first became actively interested in consumer credit, it was relatively easy to recognize an industrial bank. The list we prepared included those insured banks originally chartered under special statutes for industrial banks or banking companies or under a special section of the banking code; of course, it included your members, for the name Morris

Plan was unmistakable; and it also included other banks operating under a variety of charter forms whose characteristics labelled them definitely as "industrial banks".

In 1941, and prior years, those characteristics were clear cut. Most industrial banks were in large centers with a population of 50,000 or more, and the differences from their neighbors were marked. They were smaller. Their loans — practically all of them consumer instalment loans — accounted for three-quarters or more of their total assets; and their holdings of cash and due from banks, securities and miscellaneous assets were nominal. Their neighbors, the commercial banks — in the larger centers particularly — had difficulty maintaining 30 percent of total assets in loans; and had cash assets and securities of about 30 percent each.

On the other side of the balance sheet, practically all of the deposits (85.4 percent) of insured industrial banks were in the form of time and savings deposits, and their capital ratios, on the average, were well above those of commercial banks in cities of comparable size. Yes, there was relatively little evidence even as late as 1941 of the magnitude of the changes which were about to take place in the industrial banks. These changes have been so profound that I was tempted to use as the title of this address the question "Has the Industrial Bank Disappeared?" These changes have been so profound that I doubt if any of us could have expected them to occur in the space of four short years.

Most of these changes occurred as a result of the sharp expansion of credit incident to the financing of the war; they were common to all types of credit institutions. From December 1941 to December 1945 assets of insured commercial banks practically doubled, with over 80 percent of the increase in the form of United States Government obligations. Almost all of the rest of the increase consisted of the increase of cash and amounts due from banks. Aggregate changes among insured industrial banks were similar in character, but proportionately greater. Deposits of 78 identical insured industrial banks grew by 169 percent over the four year period. Again over 80 percent of the increase in total assets took the form of United States Government securities, with another 13 percent consisting of increased cash and due from banks.

However, while the most pronounced change was tied up directly with war financing, some changes reflected wartime restrictions on consumer credit, and others, the desire of individual industrial banks to enlarge the scope of their activity. While time deposits of insured industrial banks increased by about 70 percent, demand deposits increased more than 700 percent. Total loans increased about 25 percent while consumer loans decreased by one-third. Also in 1945 over one-fourth of the consumer loans consisted of single payment loans which had been of relatively minor importance in industrial banks before the war.

II

By the end of 1945 these shifts had had a profound effect upon the asset holdings of insured industrial banks considered as a group. Almost 50 percent of their total assets were in the form of United States Government obligations, and about 30 percent in loans. Less than one-third of their loans, or about 10 percent of total assets were represented by consumer instalment loans. This was a far cry from the prewar asset distribution!

Great as these changes are, they have not affected all of the industrial banks in the same way, or to the same degree. Some still have only time deposits; some still have high capital ratios; some still have over 50 percent of their total assets in loans; and some still have only consumer paper in their loan cases. The variation cannot be simply explained: It is not entirely a case of difference in size, although banks with deposits of less than 2 million dollars have departed less from the traditional pattern; it is not entirely a matter of location, although those in North Carolina still have a greater resemblance to their prewar picture; it is not entirely a question of size of city, although smaller towns have departed least from the fold; it is not entirely a matter of age, although those industrial banks which have been admitted to insured status in the last few years still seem to follow the traditional pattern.

So to summarize our retrospect, we have noted a high degree of diversity of action among the industrial banks in their attempts to adjust to the pressures and opportunities of the wartime period. This has led them into different paths, and there is a marked variation in their present positions. While some continue in the traditional field of specialized service to the public, others have reached a point at which they cannot be readily distinguished from that large number of commercial banks which have become active in the consumer instalment field. If the deluge of name changes among your membership in recent months means anything, more of you are deserting familiar haunts and seeking broader fields.

III

As we turn from retrospect to prospect, and look at the future, let me say at the outset that I am an optimist with respect to the future of this country, and of its insured banks. Consumer credit will play a large part in that future. Production and national income will grow, bottlenecks will be eliminated, standards of living will improve and income will be better distributed. But not without temporary periods of interruption. And so I would be a student of pure theory, locked up in an ivory tower, if I did not feel some concern with respect to the developments among the banks whose deposits are insured by the FDIC. This morning it is fitting that our note of caution be expressed in terms particularly applicable to industrial banks.

My observations with respect to your activities fall into two groups, those in the consumer credit field, and those in the commercial field. For you still have a larger stake in the consumer credit field than the average commercial bank; and we have evidence of your increasing interest in commercial banking. You will, I hope, permit me some observations with respect to your consumer credit activities; I realize that some of you have learned by the experience of thirty-six years in this field; of course my studies have taken place over only a small portion of that long period.

Originally and traditionally you made your reputation in direct lending to consumers. I do not need to tell you that you have done a superb job. Your operations have been thoroughly streamlined, your charge-offs have been negligible, your profits satisfactory, and you know your costs. In this field all of you have been affected to a greater or lesser degree by growing competition. That competition will prompt you, I know, to charge the lowest rates consistent with safety of operations and with a reasonable rate of return on your invested assets. Your good judgment will recognize the folly of charging lower rates than that. I do not believe your commercial bank competitors, in their desire to secure volume, will consciously quote rates below the level set by costs and reasonable profits. I hope that each one will know his costs so well that he will not do it unconsciously. You are aware of the manner in which the American Bankers Association and other banker groups have emphasized to their membership the absolute necessity of knowing how much their costs are; I believe you will agree that everyone should applaud their educational efforts in this direction.

In recent years you have also shown an increasing tendency to acquire retail instalment paper, and you have been particularly agressive in that field in recent months. While the debate has raged over the relative merits of retail paper acquired from dealers as compared with direct loans, most of you appear to have chosen the former alternative. By that method you attain low acquisition costs and a relatively substantial volume of business once the necessary contacts with retailers have been made. But with the high volume comes the temptation to accept all of a dealer's paper even though some is below your normal credit standard. To be sure, sales finance companies have not experienced a substantial rate of loss even though they have relied less on the credit of the retail purchaser than on the dealer's reserve or repurchase agreement or the resale value of the repossessed article. But if you wish to follow that example, you must master the maze of technical problems which such reliance creates; and probably the most important single lesson to learn is to act rapidly after a default occurs. Because it is almost axiomatic that a borrower who neglects to pay also neglects to maintain the article to be repossessed.

He who acquires retail paper indirectly, also has the problems of its Siamese twin — floor financing of dealers. Here the two chief problems are over-extension of credit and the subsequent inability to move inventories. Today there is still a sellers' market for most commodities, but we have already seen a rapid somersault from a sellers' into a buyers' market in the case of table model radios of lesser known brands. Now I do not pretend to be a forecaster of business conditions, but warning signs on the horizon indicate that we may have similar somersaults elsewhere. I do not know when the turns will take place, and they may not occur soon. Production may well overtake demand in one important class of durable goods at a time rather than occurring for all at once. We have become so accustomed to the thought of sellers' markets that we may fail to exercise normal precautions to see that the dealer does not become overloaded. As you know, when the retailer becomes overloaded, it is too late; for then the sellers' market has become a buyers' market.

As you turn to activities in the commercial bank field, it is logical for you to continue to emphasize your service to the individual and to the small business man, so as to retain the individuality and good-will which you have built up. It is also logical that you should attempt to apply the principles you have learned so well in your consumer credit activities.

In consumer credit, you have shown yourselves to be masters of the technique of handling a large number of relatively uniform transactions efficiently. One field to which you can and are successfully applying this technique has been in the development of no-minimum-balance checking accounts. One bank whose demand deposits last December amounted to seven million dollars has recently advertised that it serves 27,500 checking accounts. Others of you have decided that service to the individual can best be expanded by specialization in FHA title II loans and have developed a large amount of such business. From the origin of the Morris Plan in 1910, you have been known as specialists; it is logical that you should continue as such, adding one specialty after another to your list of services, as your ability permits and the needs of the community require.

You will note I said, "As your ability permits." Your men became specialists in consumer credit through years of study and experience. You will recognize, however, that they do not become specialists in real estate loans or in other fields, overnight, simply by changing signs on desks or titles. Much has been written and said in recent years to emphasize to commercial bankers that they cannot successfully engage in consumer credit activities without study, experience, and qualified personnel. Though little has been said, the same is true of other lending activities. So before entering upon new lending activities such as real estate mortgages, large commercial loans, accounts receivable financing or commodity loans, ask yourself the following question, "Have I the proper staff and organization to qualify for success in this new field?"

When you developed the Morris Plan, you pioneered in the development of a new technique. It is possible and probable that you will now be attracted to or devise other new techniques for serving the public, both the individual and the small business man. There appears to be ample evidence that there is a large field for lending to small business in which new techniques could be fruitfully applied. There is progress in the development and application of new techniques but there are also pitfalls. All that is new is novel, but it may not be efficient and it may not be sound.

Specialization with respect to type of transaction or a particular technique may lead to unsound concentration in a single industry, or in a single line of endeavor. All of us recall the banking difficulties in agricultural areas in the twenties. These resulted from the concentration of loans on a single agricultural crop, locally predominant. Therefore, I hope that a sound decision to specialize will not mislead you to the point where the fortune of your bank will depend unduly upon the fortune of a single crop, a single commodity, or a single type of mercantile, industrial, or farming endeavor.

A last word with respect to profits. If the assets of your bank grow as it takes on commercial activities, you may reasonably look forward to a growth in the dollar amount of your gross earnings, your net earnings and your net profits. But the <u>rate</u> of your net earnings and net profits will decline per dollar of invested assets. For as industrial banks, your rate of net profits per dollar of total assets has been about double that of the commercial bank. Furthermore, your rate of net profit per dollar of net worth will grow only if your capital ratio goes down. As that goes down your risk increases. As your capital ratio goes down, your vulnerability, if you have made mistakes in acquiring assets, increases.

Consider that in connection with one other factor. I have heard it said that the industrial bank which is entering the commercial bank field must accept and be willing to take loans which no other bank would make. If that means that you must make substandard loans, I disagree, and I hope you do too. I do not deny that it is the function of a commercial bank to accept risks in lending. It is proper for a bank to supplement the capital in a business but not to supply the capital for that business. Any tendency on your part to make loans on narrow margins in the hope that you can pick the peak in the stock market, in the commodity market, in real estate, in business activity, is fraught with danger.

But, as we conclude this retrospect in which we have noted the changing character of numerous insured industrial banks and this prospect in which we have made some observations about their consumer credit and commercial banking activities, I can do no better than to quote from the latest Annual Report of the Federal Deposit Insurance Corporation. "Prices will not always rise. Employment and business activity will not always increase." When prices fall and business activity decreases, I hope your bank will find that the assets on its books are sound.